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Nos. 1024 and 1025

IN THE
Supreme Court of the United States
OCTOBER TERM, 1964

No. 1024

FEDERAL POWER COMMISSION, *Petitioner*

v.

PAN AMERICAN PETROLEUM CORPORATION, *Respondent*

No. 1025

PENNSYLVANIA PUBLIC UTILITY COMMISSION, *Petitioner*

v.

PAN AMERICAN PETROLEUM CORPORATION, *Respondent*

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Tenth Circuit

BRIEF FOR RESPONDENT IN OPPOSITION

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BRIEF FOR RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Court of Appeals for the Tenth Circuit is reported at 339 F. 2d 694 and is printed as Appendix A to the Petitions for Writs of Certiorari. The opinion and orders of the Federal Power Commission (J.A. 241-250, 259-260) are reported at 30 FPC 1477 and 31 FPC 241.

JURISDICTION

The jurisdictional requisites are adequately set forth in the Petitions.

QUESTION PRESENTED

Whether the Federal Power Commission has jurisdiction under the Natural Gas Act over the conveyance of interests in oil and gas leases consummated prior to completion of drilling and field development, prior to establishment of permanent gas production units, and prior to connection of completed wells to gas transmission or collection facilities of an interstate pipeline.

STATUTE INVOLVED

The pertinent provisions of the Natural Gas Act, 52 Stat. 821, 15 U. S. C. §§ 717-717w, are set forth in each Petition on page 2 thereof.

STATEMENT

This case involves an attempt by the Federal Power Commission to obtain approval of contentions that a conveyance of interests in oil and gas leases can be considered a "sale in interstate commerce of natural gas for resale" in applying Section 1(b) of the Natural Gas Act. In this instance, the conveyance took place in December, 1960; the assignee thereafter completed field facilities, connected its wells, and began producing and delivering into its interstate system in February, 1961; the Commission initiated its inquiry as to the assignor in March, 1962, and claimed "jurisdiction" over the 1960 conveyance by an order issued in December, 1963. The Court of Appeals for the Tenth Circuit reversed, and Petitioners now seek review of the question of Commission jurisdiction. Pertinent background is as follows:

1. Leasehold interests involved are in twelve leases in the Bastian Bay Field, Plaquemines Parish, Louisiana (J.A. 140-145). This field lies onshore in low-lying marshes in the Mississippi River delta approximately 55 miles southeast of New Orleans, and the leases cover both surface acreage owned by private lessors and water bottoms owned by the State of Louisiana (J.A. 56). As far as can be ascertained, there was no exploration in the area prior to 1939 when a dry hole was drilled at a depth of 12,257 feet outside productive limits of sands subsequently discovered; thereafter, in the mid-1940's, shallow oil production was discovered in the eastern part of the area, but reservoirs then discovered are not the same reservoirs subsequently discovered in the western part of the area, and now referred to as the Bastian Bay Field (J.A. 57).

Pan American Petroleum Corporation acquired its first lease in September, 1954, and eleven more leases between that month and October, 1959. In December, 1955, Pan American's first exploratory well was completed, and by December 1, 1960, Pan American had drilled 32 wells either wholly owned or as operator of leases in which two other companies also owned interests (J.A. 57-58). By the time of Pan American's conveyance, Pan American had drilled wells on six of its twelve leases, but none had been drilled on the remaining six.

Between acquisition by Pan American and its conveyance, small amounts of gas produced by Pan American from completed wells were consumed within the field for fuel, in artificially lifting oil wells, or were flared (J.A. 58, 167-168). At the time of conveyance the status of the leases was: (1) wells had been completed on but six of the twelve leases; (2) there were

no permanent gas production units in the field, and only two temporary units had been established;[1] (3) minor quantities of gas produced by Pan American had been consumed in the field; (4) gas collection facilities operated by another lessee were not utilized for collection of gas produced or owned by Pan American; (5) Pan American had made no sales to a pipeline for disposition either within or outside of Louisiana; and (6) wells on Pan American's leases were not connected to an interstate transmission pipeline (J.A. 57-58, 165-168).

2. Pan American conveyed its interests to Tennessee Gas Transmission Company pursuant to a Lease Sale Agreement dated July 15, 1960 (J.A. 60). Tennessee is engaged in numerous gas, oil, petro-chemical and other activities, including operation of a gas transmission pipeline subject to Commission jurisdiction. Tennessee's interest in the leases began in 1957, when Tennessee was acting as agent for another company which proposed to purchase the leases under an arrangement by which Tennessee would transport gas for it. Subsequently, Tennessee negotiated on its own behalf, and negotiations culminated in the Lease Sale Agreement, specifying, *inter alia:*

(1) estimated recoverable reserves of gas attributable to interests assigned as 759,350,000 Mcf (at 15.025 psia), and estimated recoverable reserves of oil attributable to such interests as 7,650,000 barrels;

(2) a total purchase price, subject to one redetermination, of $159,463,500, payable $9,427,104 at closing,

[1] By regulation of the Louisiana State Mineral Board, permanent gas production units can be established only after the limits of the productive sands have been determined by the drilling of development wells.

and the balance in accordance with 17 promissory notes which are corporate obligations of Tennessee only and which are not secured by a mortgage on the interests assigned;

(3) that fixed amounts in the notes could be changed but once either (a) after redetermination of reserves of gas upon written request of either party within 30 days after January 1, 1963, if prior to that date 900 billion cubic feet of gas had been produced from the field; or (b) after production of 900 billion cubic feet, if that quantity had not been so produced prior to January 1, 1969, but had been produced prior to January 1, 1973; or (c) after January 1, 1973, in any event, upon request; and

(4) that redetermination of reserves of oil could be made once upon written request of either party between January 1, 1969 and January 1, 1973.

The parties executed the conveyance in December, 1960 (J.A. 98, 115), and the Declaration of Assignment and Conveyance subsequently was recorded in Plaquemines Parish, Louisiana, leasehold records (J.A. 46-47). The conveyance, effective December 1, 1960, provided for:

(1) Conveyance by Pan American of its interests in the twelve leases insofar as they covered oil, gas, separator liquids, and natural gas liquids, in all formations above the base of known productive sands;

(2) Conveyance of Pan American's interests in wells located on such leases, gathering lines, other equipment, and easements;

(3) Reservation by Pan American of a specific, defined, and limited production payment only as to pro-

ceeds to be received by Tennessee from sale of oil until production of 85 percent of the total estimated recoverable reserves of oil;

(4) Reservation by Pan American of a specific, defined and limited production payment only as to proceeds to be received by Tennessee from sale of separator liquids after deduction by Tennessee of specified costs incurred by Tennessee in operation and development of the leasehold interests assigned;

(5) Reservation by Pan American of a right to process, or cause to be processed, all gas produced from the leaseholds assigned for recovery of natural gas liquids with payment to Tennessee of 21 cents per Mcf for reduction of volume of gas due to plant fuel consumption and losses.

Subsequent to conveyance, Tennessee assumed its rights and duties as lessee. Tennessee entered into required agreements with owners of royalty interests; arranged for operation of the leases by its subsidiary Tenneco Oil Company (J.A. 29-31); and exercised its rights to produce oil and gas, to operate the wells, and to sell or dispose of commodities produced, if as, and when so produced. Tennessee arranged for connection of its wells to a 2.63-mile gathering line constructed by it and commenced taking its gas production on February 3, 1961 (J.A. 22). Tennessee also proceeded with field operations and arrangements with other lessees and operators; connection of the field to its South Louisiana gathering and transmission lines; drilling and development of the leases; its planning for maintenance and well workovers; and each matter within Tennessee's responsibilities, rights, and duties as owner of the working interest, producer, and owner of all commodities as produced (J.A. 43-47, 54-55).

3. In early 1961, Tennessee was requested to advise the Commission as to the "authority" Tennessee relied upon to construct the 2.63-mile line, installed by Tennessee to connect its leases. Tennessee responded with reference to a certificate previously issued in the Commission's Docket No. CP61-106. Thereafter, on April 6, 1961, the Commission "reopened" that docket to determine whether the certificate provided such authority (J.A. 241). Reserving its rights as to validity of such action, Tennessee presented evidence before a Commission Examiner, including details as to the 1960 conveyance of leasehold interests.

While these hearings were in progress, the Commission on March 12, 1962, ordered Pan American to "show cause" upon the question of whether under the conveyance of its leasehold interests, Pan American could be found "to be engaged in the sale of natural gas produced at the Bastian Bay Field subject to the jurisdiction of the Commission" (J.A. 211). Pan American answered and thereafter participated in the "show cause" proceedings which were consolidated with the docket involving Tennessee.

After conclusion of these hearings, the Examiner issued a decision holding (a) Tennessee had constructed its 2.63-mile line without authority; (b) the conveyance by Pan American could be treated as a "bulk sale of gas," and (c) the transaction was subject to Commission jurisdiction under the Natural Gas Act.

Upon exceptions, the Commission issued its decision on December 12, 1963, which held (a) Tennessee had constructed its 2.63-mile line without authority; (b) Pan American's conveyance was a "sale in interstate commerce for resale" of natural gas within the meaning of Section 1(b) of the Act; and (c) Pan American

must make certificate and rate filings with respect thereto under the Act within six months (J.A. 241-250). On February 4, 1964, the Commission denied rehearing, but stayed the requirement as to filings until six months after final mandate in court review proceedings (J.A. 259-260).

4. Upon review, the Court of Appeals for the Tenth Circuit affirmed as to Tennessee,[2] but reversed as to Pan American. The court found that, in substance, the Pan American-Tennessee transaction was "not legally distinguishable" from that before the Fifth Circuit in *Marr* v. *Federal Power Commission*, 336 F. 2d 320 (1964); and that the Commission's contentions are but a "denial" of this Court's decision in *Federal Power Commission* v. *Panhandle Eastern Pipe Line Company*, 337 U.S. 498 (1949). Referring to the "basic distinction" between conveyancing of acreage and a sale of gas in interstate commerce, the court noted that such distinctions are not determined by "contemplated but unrealized benefits to the parties" or by the choice of parties to remain beyond the bounds of interstate commerce or within the exception to Commission powers. The court concluded that Pan American's conveyances were leases not within the Commission's jurisdiction, expressed its accord with the opinion of the Fifth Circuit in *Marr*, and as to Pan American, reversed.[3]

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[2] *Tennessee Gas Transmission Company* v. *Federal Power Commission*, 340 F. 2d 100 (10th Cir. 1964), *petition for cert. filed*, April 21, 1965 (O.T. 1964, No. 1093).

[3] The court thus did not reach issues raised by Pan American as to constitutionality of the Natural Gas Act, assuming *arguendo* that, as contended by the Commission, the statute means that a conveyance of interests in oil and gas leases may be "treated" as a "sale of natural gas" "in interstate commerce" and the subject of regulation on the basis of such "treatment" (see J. A. 2, 9).

SUMMARY OF ARGUMENT

Questions similar to those stated by the Federal Power Commission in No. 1024 and by the Pennsylvania Public Utility Commission (an intervenor below) in No. 1025 are before this Court in *United Gas Improvement Company* v. *Continental Oil Company, et al.*, and *Federal Power Commission* v. *M. H. Marr, et al.*, Nos. 644 and 693, this Term, in which petitions for writs of certiorari were granted on January 18, 1965. However, we do not agree with Petitioners' suggestions that the instant petitions can be held to await disposition of those cases and submit that the instant petitions must be denied forthwith.

First, the questions as stated in Nos. 1024 and 1025 assume validity of factual assertions in both petitions that leasehold interests conveyed by Pan American have been found to be "in proven natural gas reserves," a technical factual conclusion not made below and not a predicate of the holding below.[4] The decision below

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[4] The question of whether the leases here involved could be correctly found to be "proven" at the time of conveyance arose during hearings before the Commission, and the Examiner found only that as a result of drilling by Pan American, the acreage covered by assigned leases "became proved gas properties" (J.A. 213, 217). On exceptions, the Commission found the leases to have been "developed," but also found that no wells had been drilled on six of the twelve leases involved (J.A. 241, 244), and made no specific finding as to underlying "proven natural gas reserves"—the technical conclusion now asserted in the Petitions here. By its Petition for Review, Pan American drew into question such factual conclusions as the Commission did make (J.A. 2, 10). The court below, although referring to the "field" as "proven," referred to the facts that no wells had been drilled on six leases conveyed; made no finding that the leasehold interests were, as now asserted here, "in proven natural gas reserves"; and, at least by inference from the references to *Marr*, apparently correctly assumed no valid factual reason to distinguish state of develop-

rests upon the conclusion that the specific conveyance of leasehold interests involved here is not subject to Commission jurisdiction under Section 1(b) of the Act, a conclusion reached after review of the record and summary of the facts existent at the time of this conveyance. The decision does not rest upon a precedent factual conclusion as to "proven" reserves underlying the leasehold interests at the time of conveyance, and a decision here resting upon such a factual assumption thus would be inconsistent with the facts and findings below. The instant petitions therefore do not frame questions properly before this Court in relation to the record and holding below and should be denied for this reason alone.

Second, by reference to the *Marr* case, Petitioners advance as reasons for granting their petitions (1) contentions rejected below that conveyances of leasehold interests may be "treated" as sales of natural gas in applying the Act; (2) suggestions that the decision

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ment of the twelve leases here involved from state of development in 1949 of the leases that were the subject of this Court's decision in the *Panhandle* case.

The facts are that the leases here were "proven" only in the sense that the productive sands found in the discovery and subsequently drilled wells could be assumed to underlie all of the twelve leases. The undrilled leases were thus not "proven" in the sense that the productive sands had been found to underlie them by wells drilled thereon. Moreover, it is an obvious fact that the leases were not developed by December, 1960 to the extent which would be required in order to make an accurate estimate of the recoverable reserves of oil and gas. If they had been so developed, as Petitioners would have the Court believe, it would not have been necessary for Pan American and Tennessee to provide for a minimum development program and a redetermination of recoverable reserves after full development of the leases. An unbiased examination of the facts clearly demonstrates that the leases involved here were in a stage of being "proven" and "developed" comparable to the "unproven" leases lying within the Hugoton Gas Field involved in *Panhandle*.

below rests upon misreading of decisions of this Court; and (3) the usual contention that a decision adverse to the Federal Power Commission has created a "gap" in regulation. As shown in this brief, the decision below is in accord with this Court's constructions of the Act; because of powers the Commission clearly possesses, no "gap" in effective regulation results; and the petitions should be denied.

ARGUMENT

I. The Court Below Correctly Has Held That the Conveyance of Leasehold Interests in This Case Is Not Subject to Commission Jurisdiction Under the Natural Gas Act

By reference to *Marr,* Petitioners seek this Court's indulgence in a fiction of "treating" a conveyance of leasehold interests as a "sale" of "natural gas" for purposes of applying Section 1(b) of the Natural Gas Act. Conceding that under property law such a transaction *is* a conveyance and not a "sale" of the commodity "natural gas,"[5] Petitioners not only would overturn all authoritative construction of the Act merely by the assertion that the Commission should be held "warranted" to ignore the Act, but also would overturn well-established principles of oil and gas property law by the mere assertion of the same "warrant." This "warrant" is said to be found in "economic reality," "practical incidents," and "judgment." The fact is, however, that the claimed "warrant" has no support in the statute and no foundation in underlying facts relevant to rational, informed judgment in this case.

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[5] In No. 1025, Petitioner refers to the "device of transferring property" (Petition, p. 6); in No. 1024, Petitioner refers to its brief in *Marr* which contains the statement: "The fact that State conveyancing law may regard it [a conveyance] as a transfer of real property interests is not controlling." (pages 18-19).

By its terms, Section 1(b) is applicable only to "sale in interstate commerce of natural gas for resale" and is inapplicable to "any other" "sale." Section 2(5) of the Act defines the term "natural gas" as "either natural gas unmixed, or any mixture of natural and artificial gas"—terms properly construed almost a decade ago to have the normal definitions of a "mixture of gaseous hydrocarbons found in nature."[6] This Court and the Courts of Appeals thus have held the language of Section 1(b) applicable to wholesale sales of the commodity natural gas in fields of production, but also have adhered to the elemental distinctions between that commodity and other items of property, and to the concept that "natural gas" exists as a commodity within the meaning of the Act when capable of sale and transportation after production by bringing the gas "forth from the earth."[7]

Properties merely used in production—including leasehold interests—thus do not fall within the statutory definitions but are "comprehended" by the statutory "phrase" "production or gathering." *Federal Power Commission* v. *Panhandle Eastern Pipe Line Company,* 337 U.S. 498, 504-505 (1949). In brief, the concepts familiar in both state and federal law, written into the Act in 1938, and existing today, are those once stated by the Commission in expressing the dichotomy between the commodity capable of sales subject to its jurisdiction and the properties which are but means of

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[6] *Deep South Oil Company* v. *Federal Power Commission,* 247 F. 2d 882, 888 (5th Cir. 1957), *cert. den. sub nom. Humble Oil & Refining Company* v. *Federal Power Commission,* 355 U.S. 930 (1958).

[7] *Saturn Oil & Gas Company* v. *Federal Power Commission,* 250 F. 2d 61, 65 (10th Cir. 1957); see also *Phillips Petroleum Company* v. *Wisconsin,* 347 U.S. 672 (1954).

producing that commodity: ". . . natural gas becomes a subject of commerce when it is reduced to possession. *Pennsylvania* v. *West Virginia*, 262 U.S. 553, 558."[8] Only then does that commodity exist as contemplated by the Act, and it is only the sale of that commodity after production which is "commerce" to which the Act applies.

As recognized below, a conveyance of a leasehold interest cannot convey "natural gas" in either property law or in "practical reality." The owner of a leasehold interest possesses only a right to drill and produce and he may sell "natural gas" as an article of commerce only if he produces, and then only in such quantities as he physically is able to recover and deliver to a purchaser.[9] If he conveys his leasehold interest, he has conveyed only those rights and nothing else, even if those rights pertain to a leasehold overlying a reservoir that is believed to contain no commodity other than dry gas. After conveyance, the assignee then may proceed as he chooses; subject to the terms of his lease, he may determine when and where to drill and when and how much to produce; if he produces, he then may sell what he produces in intrastate commerce; or he may sell his commodity in interstate commerce. Regardless of the assignee's choice, the assignor of the leasehold interest has conveyed no "natural gas" and has not engaged "in interstate commerce" by a sale of gas. A "sale" of "natural gas" "in interstate commerce" can occur, if at all, only upon the subsequent events of production and initiation of deliveries at the election of

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[8] *Re Continental Oil Company*, 18 FPC 296, 520 (1957); *aff'd*, *Continental Oil Company* v. *Federal Power Commission*, 266 F. 2d 208 (5th Cir. 1959).

[9] See, e.g., J.A. 168-175.

the assignee. Property involved can become "dedicated," and a seller can become subject to " . . . the jurisdiction of the Commission's regulatory control within the statutory limits of the Act . . .," only after production and commencement of deliveries of produced gas and then only if the assignee so elects. See *Sunray Mid-Continent Oil Company* v. *Federal Power Commission,* 270 F. 2d 404, 409 (10th Cir. 1959), and *Atlantic Refining Company* v. *Public Service Commission of New York,* 360 U.S. 378, 387-388 (1959).

Here, the Commission conjures a fiction unrelated either to Section 1(b) or to reality. Pan American conveyed interests in twelve partially developed leaseholds; existing wells then were unconnected to an interstate transmission system; reservations in the conveyance as to production payments only are wholly consistent with valid, bona-fide conveyance of working interests in leases; consideration is neither geared to nor controlled by gas production; and Pan American's functions as lessee, operator, producer, and possessor of rights to sell commodities ceased with the conveyance. "Proven natural gas reserves" were not conveyed, in the sense asserted by Petitioners, and no valid analogies to a "conventional" sale of "natural gas" can be drawn upon this record.

Tennessee, as assignee and lessee, owns the leaseholds, functions as a producer by its own choice, operates through its subsidiary, and disposes of commodities as produced as it sees fit. Moreover, to emphasize the point, it should be noted that Tennessee could have sold its interests in the leases at any time after December, 1960, to another person who might not have produced the leases for gas for sale for resale in interstate commerce. The fact that subsequent to the conveyance

Tennessee elected to introduce its produced gas into its transmission system does not and cannot operate retroactively to transform the conveyance by Pan American into something the conveyance was not in 1960, and is not today, as a matter of state and federal law and as a matter of fact.

The court below thus has correctly rejected a conjured fiction which has no "reasonable basis" either in statutory language or construction or upon the facts in this case. As correctly held below, no "sale" of "natural gas" "in interstate commerce" by Pan American has taken place, and therefore, as to Pan American, there has been no act or transaction to which Section 1(b) of the Act applies.

II. The Decision Below Is in Accord with This Court's Constructions of Section 1(b) of the Act

Petitioners, by reference to contentions in *Marr*, seek to suggest that the decision below rests upon misreading of decisions of this Court, but the opposite is the case—Petitioners' contentions are in conflict with *Federal Power Commission* v. *Panhandle Eastern Pipe Line Company*, 337 U.S. 498 (1949), and *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672 (1954), and with the clear import of *Atlantic Refining Company* v. *Public Service Commission of New York*, 360 U.S. 378 (1959), and *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 364 U.S. 137 (1960).

In *Panhandle*, after arguments substantially parallel to those made here, this Court held that the Commission has no jurisdiction over the transfer of interests in leases. That decision was not predicated upon nature of lease development, identity of an assignor

or an assignee, or the expressed or unexpressed private intentions of an assignee as to subsequent disposition of gas to be produced in the future. This Court also indulged in no spurious fictions as to "sales," but was clear in its expressions that leases are a part of "production" and beyond the reach of the Act.

In *Phillips*, this demarcation between nonjurisdictional properties and commodity sales subject to jurisdiction was not blurred, but emphasized. Referring to *Panhandle* and to *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581 (1945), this Court repeated its construction of Section 1(b): ". . . the 'natural and clear meaning' of the phrase 'production or gathering of natural gas' is that it encompasses producing properties and gathering facilities of a gas company'."[10] *Phillips*, in accord with *Panhandle*, thus recognized that although Commission certificate jurisdiction may apply to field sales of produced commodity natural gas, "facilities" used in production, producing properties, and lease-hold equipment are exempt.

Subsequent to *Phillips*, in *Atlantic* and *Sunray*, this Court had further occasion to refer to the "jurisdictional facts" contemplated by Section 1(b) and prerequisite to application of Commission powers under Section 7 of the Act. In both cases, reference was made to the facts that it is *only* by initiation of deliveries of the produced commodity natural gas that Commission jurisdiction finally attaches, and that even where a certificate has been issued, an applicant remains free to "withdraw" if deliveries of that com-

[10] *Phillips Petroleum Company* v. *Wisconsin*, 347 U.S. 672, 678 (1954).

modity have not commenced.[11] The clear import of these decisions is that the Act imposes no bar to conveyance of interests in leases in a partially developed field "committed" to no gas sales contract and from which no deliveries have ever commenced.

The court below thus has correctly applied this Court's constructions of the Act. The suggested "conflict" does not exist, and Petitioners' argument is dependent solely and only upon acceptance of the spurious fiction that a transfer of leaseholds is a "sale" of "natural gas" a fiction rejected by the Courts of Appeals and in conflict with the very decisions cited by Petitioners.

III. No Regulatory "Gap" Exists or Has Been Created

Both Petitioners attempt to establish that the decision below creates a "gap" in effective regulation. Reference to existing powers of the Commission over interstate pipeline companies demonstrates invalidity of this argument and that it is urged here prior to even an attempt by the Federal Power Commission to exercise powers it clearly possesses under Sections 4, 5, and 7 of the Act.

Before and after passage of the Act, pipeline companies such as Tennessee have acquired leases, produced gas, and sold their produced gas to local distribution companies for resale.[12] In both rate and certifi-

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[11] See *Atlantic Refining Company* v. *Public Service Commission of New York*, 360 U.S. 378, 387-388 (1959); *Sunray Mid-Continent Oil Company* v. *Federal Power Commission*, 364 U.S. 137, 141 (1961).

[12] *Federal Power Commission* v. *Hope Natural Gas Company*, 320 U.S. 591 (1944); *Colorado Interstate Gas Company* v. *Federal Power Commission*, 324 U.S. 581 (1945); and *Panhandle Eastern Pipe Line Company* v. *Federal Power Commission*, 324 U.S. 635 (1945).

cate cases, the Commission has evaluated these facts and in the past concluded that pipeline ownership enhanced pipelines' economic positions, promoted stability and certainty of supply, contributed to flexibility of takes and operations, was beneficial to customers and consumers and otherwise was in the public interest.[13] Aside from these benefits, such ownership can affect ultimate consumers only through rates charged by a pipeline and the possible allowance in those rates of amounts for any gas produced by the pipeline and resold by it. In Section 4 and 5 rate cases, any such allowance is always subject to direct, continuous Commission review and control, as the Commission concedes in its brief in *Marr*:

> "To be sure, the Commisison would have power to examine these transactions in a proceeding to determine just and reasonable rates for the pipeline purchaser, and at that time—at least in theory—could disallow such portion of the leasehold acquisition costs as it found to be improvident."[14]

Thus, under the Act, if a pipeline acquires leases and introduces its produced gas into its system, the Commission has absolute power over rate impact, whether the Commission applies Section 4 and 5 rate standards to pipeline-produced gas on a cost-of-service basis as in the past,[15] or on the "area rate" basis as

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[13] See *Re Panhandle Eastern Pipe Line Company*, 13 FPC 53, 74-75 (1954); *Re Texas Eastern Transmission Corporation*, 21 FPC 860, 867 (1959).

[14] "Brief for the Federal Power Commission," *Federal Power Commission* v. *M. H. Marr, et al.*, No. 693, O.T. 1964, p. 38.

[15] See *City of Detroit* v. *Federal Power Commission*, 230 F. 2d 810 (D.C. Cir. 1955), *cert. den.* 352 U.S. 829 (1956).

now contemplated.[16] At the time of an acquisition, rates in effect for a pipeline always are those previously so fixed by the Commission as "reasonable" under Section 4 or 5; *any* increase of rates thereafter must pass Commission scrutiny under those sections; and any *new* rates including a "cost" or allowance attributable to an acquisition, or to pipeline-produced gas, will and can exist only *if* the Commission itself has approved such new rates as "reasonable" *after* testing, finding facts, and applying rate case criteria. This absolute power to insure protection of consumers under Sections 4 and 5 exists at all points in time regardless of how the pipeline acquires leasehold interests, of who may be an assignor, or of what authority the pipeline holds to connect wells and introduce gas into its interstate system.

As to Section 7 powers, the Court of Appeals for the District of Columbia correctly outlined the Commission's available courses in *Public Service Commission of New York* v. *Federal Power Commission*, 287 F. 2d 143 (D.C. Cir. 1960). If a pipeline, after an acquisition, does not have requisite certificate authority for facilities to connect a field to its interstate system, it must apply for such authority under Section 7. The Commission then may deny the application under Section 7 standards, *or* express itself as to future treatment of costs in the pipeline's subsequent rate cases, *or* expressly disclaim any approval of costs and grant the application subject to appropriate conditions as to segregation of accounts pertinent to subsequent Commission review in rate proceedings under Sections 4

[16] See "Order Enlarging Issues" issued June 29, 1964, in FPC Docket Nos. AR64-1, *et al.* (Area Rate Proceeding, *et al.*, Hugoton-Anadarko Area), —— FPC ——.

and 5. No matter which choice the Commission makes in a Section 7 proceeding, absence of jurisdiction over an antecedent acquisition and an assignor does not bar or impede the exercise of these powers under Section 7 or the protection thereunder of the Commission's Section 4 and 5 rate jurisdiction.

Despite this absence of any "gap" in effective regulation and the views of three Courts of Appeals, the Commission simply declines to exercise the jurisdiction it clearly possesses under Sections 7, 4 and 5. Its reasons apparently are those set out in its brief in *Marr*, but none has the support of a history of effort, a record, or testing under the regulatory scheme of the Act. There, the Commission merely questions "practicalities" of its exercise of its powers; erroneously suggests that in pipeline rate proceedings, it would not have before it the hard facts of costs, reserve estimates, and production history which the Commission has had before it in all such cases since 1938; implies that the Commission alone, rather than staffs of the pipeline, are the authors of the expert cost and market studies always considered in pipeline certificate and rate cases; and questions whether rate standards historically used (and used by the Commission today) are feasible because of "complexity" and the requirement for exercise of "judgment." Contrary to such suggestions, the "practicalities" differ little from the grist of today's regulatory mill in both pipeline and producer rate cases, and the tasks so referred to by the Commission are unaffected by continued judicial recognition that the Commission does not have the additional burden of regulating transactions in leasehold interests.

By reference to *Marr*, Petitioners also suggest that pipeline acquisition of leasehold interests without Com-

mission approval somehow creates a new "risk" to be borne by consumers, but this argument is even less credible. If a producer retains leasehold interests, produces natural gas, and sells its produced gas in a jurisdictional sale, *lawful* rates fixed for that producer under the "just and reasonable" standard must contain a component compensating the seller for attendant "risks" and for costs attributable to attracting capital. If a pipeline acquires leaseholds and acts as a producer, similar considerations will apply in its rate cases. In either event, compensation for risks and cost of capital attributable to the nature of the producing segment of the industry, thus must be a component of any *lawful* jurisdictional rate whether that rate is collected by an independent producer or by a pipeline-producer.

The Commission, however, suggests that if in a pipeline rate proceeding it should disallow a portion of an acquisition cost as "improvident," the Commission somehow would "risk" impairing the pipeline's "financial status," but this suggestion does not withstand analysis. Disallowance merely means that such portion disallowed, and such portion only, would not be recovered in a jurisdictional rate; the disallowance would not affect ability of the pipeline to recover that portion of its costs in nonjurisdictional activities or through the sale of commodities other than natural gas; and, when related to the aggregation of properties and diversified sources of income of pipeline companies assessed by investors, such disallowance of a portion of costs could have no more predictable effect on ability to attract new capital than the effect which normally results from Commission decisions under Section 4 or 5 ordering any reductions in a pipeline company's jurisdictional rates.

In short, Petitioners' "risk" argument rests first upon the erroneous premise that the "risks" of owning producing properties would be irrelevant in fixing lawful compensatory rates for a non-pipeline producer, and then upon the unsupportable hypothesis that the financial status of a company such as Tennessee actually could be jeopardized by a single act of the Commission in a future rate proceeding.

Lastly, Petitioners suggest that a "device" suddenly has been created debilitating effective consumer protection. As shown, no "gap" actually exists, and past, present, and future acquisitions of leasehold interests by pipeline companies have been and will be directly responsive to the Commission's policies of encouraging or discouraging such acquisitions through exercise of its powers over pipeline companies under Sections 7, 4 and 5 of the Act. Pipeline acquisitions between 1954 and 1961 followed announced Commission policy and stated encouragement (see J.A. 241, 247-250); and Commission powers to express its policies, as well as its applicable powers under Sections 4, 5 and 7, remain unaffected by the decision below. Here, the assignee has proceeded with a transaction consistent with contemporaneous policy expressions; that policy obviously has changed, but such a shift neither means that the act of acquisition in 1960 was "jurisdictional" nor that a "device" for defiance of the Act or Commission policy suddenly was created. In sum, no "gap" in effective consumer protection follows from the decision below, and the fact that in this instance parties acted in a manner consistent with the Act and Commission policy, as expressed prior to 1961, is no valid reason for overturning the Act or this Court's construction that the Act does not vest the Commission with

jurisdiction over the assignment and conveyance of leasehold interests.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petitions for writs of certiorari should be denied.

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